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Citation: Greenhalgh, Paul (2017) The real story behind the row over UK business rates. The Conversation. ISSN 2201-5639

Published by: The Conversation Trust

URL: <http://theconversation.com/the-real-story-behind-t...<http://theconversation.com/the-real-story-behind-the-row-over-uk-business-rates-74324>>

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The real story behind the row over UK business rates

March 14, 2017 2.04pm GMT; Updated March 17, 2017 3.04pm GMT

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The tax that small business owners pay on their premises has offered a useful lesson in how the ripples of a financial crisis can leave us floundering years later. It also laid bare a stark divide between north and south in the UK, and sent the ruling Conservative Party rushing to fend off the fury of small business owners, on whose support they could normally rely.

Emotions are running high thanks to the 2017 revaluation of non-residential properties in England, Scotland and Wales. This is based on the market rent of premises at April 1, 2015 and has raised the prospect that some businesses will be saddled with huge increases in their bills; a fear that was acknowledged by the chancellor of the exchequer, Philip Hammond, in his first budget.

Hammond introduced three measures designed to head off a row. It was no surprise that it included a headline-grabbing effort to soothe the nerves of Britain's publicans, with the vast majority of pubs handed a £1,000 discount on their business rates. Hammond also capped at £50 the monthly payments for businesses who would find themselves paying rates for the first time and established a £300m fund to help owners who were struggling with increases.

In truth these sops amount to small beer and are only part of the wider picture. The reality has been much misunderstood.

Value judgement

The recent story of business rates in Britain is essentially one of bad timing. And it should be no surprise that the outcry from small businesses was, to some degree, orchestrated by a media that is centred on London and the south-east. What has often gone unreported is that, outside of London and the wider south-east, most retail, pub, office and industrial occupiers have been paying too much in rates for the best part of seven years.

The reason for this is that the previous revaluation, in 2010, was based on 2008 values, when commercial markets were at their peak, just before the impact of the credit crunch and subsequent recession was felt. While national average commercial and industrial rents had recovered to their pre-recession peak by 2015, this was driven by strong rental growth in Greater London, while rental growth outside of Greater London remained subdued. Central London offices surpassed their 2008 peak by the first quarter of 2014, but regional office rents were still languishing at 90% of their 2008 peak in August last year.

Thus, for businesses of all shapes and sizes around most of the country the latest revaluation has not come a moment too soon. The flip side is that, having been under-rated for at least three years, businesses in London are seeing their rateable values increase

substantially. The Centre for Cities think-tank calculates that London's overall contribution will increase from 17% to 21% of all business rates, more than the next 19 cities combined.

Rates of return

The story isn't as simple as a revaluation in line with the market. For some businesses, the rateable value of their premises may have increased significantly, but this is not the only factor in the rates they have to pay.

In fact, the business rates multiplier which is used to calculate the tax has actually reduced by 1.8 pence in the pound to 46.6p for small businesses and 47.9p for larger businesses. So, if your local coffee shop has a new rateable value of £20,000 then it would pay about £8,400 in rates per year.

In addition, the amount by which a ratepayer's business rates can increase or decrease is capped – after all, the smaller the business the tighter the margin and the harder it is to absorb extra costs. That same coffee shop would see a maximum 5% hike in rates however much the revaluation added.

And, much like income tax only kicks in after a certain level, there is a similar threshold below which small businesses pay no business rates at all. That has been increased to a rateable value of £12,000 from April 1 2017. And remember, Hammond brought in the £50 a month cap for those who find themselves paying rates for the first time after the revaluation.

According to the Centre for Cities, only London and Reading will experience an increase in average rates, and there are only five cities where the majority of businesses won't be exempt from paying business rates.

Appealing prospect

You might think that a simple solution to the problem of valuations that fail to match market rents would be to have more frequent valuations. This is easier said than done. The time and resources required to value nearly two million separate premises are considerable. The government has sought feedback on how to deliver more frequent valuations. We are still waiting for the results.

The complexity is ramped up by the appeal system. Following the 2010 revaluation of 1.8m premises there were about one million appeals. Seven years later, 280,000 are still outstanding. That may not be too surprising given the timing of the valuations, but is still a stark challenge.

To streamline appeals, the government has launched a new "Check, Challenge, Appeal" system. It places greater onus on the occupier to be proactive in progressing their appeal through a series of deadlines and is stacked in favour of the department in charge of valuations. That has sparked criticism that the new system is designed to grind down potential complainants and stifle appeals.

The new appeals system was intended to increase the allowable margin of error when a tribunal looked at whether a valuation was too high. In the end that didn't happen, but the appeals process remains a tough calculation for business owners. They could well end up wasting time and money to achieve nothing and still end up paying rates as much as 10% above the market, if the original valuation is deemed reasonable by the tribunal.

It's enough to have them crying in their beer – another inadvertent bonus from Philip Hammond for those vote-winning pub landlords perhaps?

This story has been corrected in the penultimate paragraph to reflect the government decision to leave appeal terms unchanged